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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Price Cap Regulation of
Local Exchange Carriers

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CC Docket No. 93-179

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)
Rate of Return Sharing)
And Lower Formula Adjustment)

COMMENTS OF BELL SOUTH TELECOMMUNICATIONS, INC.

BellSouth Telecommunications, Inc. ("BellSouth") hereby comments on the issues raised in the Notice of Proposed Rulemaking ("NPRM"), FCC 93-325, released July 6, 1993 in the captioned proceeding.

I. Introduction and Summary.

The NPRM proposes to change the way sharing and the lower formula adjustment are reflected in earnings of price cap carriers. In the NPRM, the Commission tentatively concludes that the public interest would be served by the addition of an "add back" adjustment to the earnings calculations required by the local exchange carrier ("LEC") price cap rules. NPRM at para. 15.

BellSouth agrees with the Commission that the adoption of an "add back" mechanism to the LEC price cap plan requires a rule change, not merely clarification of the existing rules. However, BellSouth sees no compelling reason to consider this issue at this time. The Commission is scheduled to begin a comprehensive review of the LEC price cap plan in just a few months. The "add back" issue

should be reviewed in that proceeding. However, if the Commission proceeds with this rulemaking at this time, it should include other issues related to earnings and sharing. With regard to the limited "add back" issue, the Commission must address all affected rules, not just the definition of "base year". Further, to the extent that the Commission adopts any rules in this proceeding, their application must be prospective only, applying to the annual access tariffs to become effective on July 1, 1994 at the earliest.

II. The Commission should defer the "add back" adjustment issue to the comprehensive LEC price cap review due to begin in just a few months.

BellSouth respectfully submits that the addition of an "add back" mechanism is just one of many possible changes to the LEC price cap plan that the Commission should consider as part of its comprehensive review due to commence later this year. Indeed, the "add back" issue arises only because of the existence of the "sharing" backstop in the LEC price cap plan. As the Commission recognizes, adoption of an "add back" mechanism would create the need for consideration of other issues, such as the "credit for below cap rates" issue identified at paragraph 16 of the NPRM.

One of the issues that the Commission will consider in the comprehensive review of the LEC price cap plan is whether to continue the "sharing" mechanism. If the Commission eliminates the "sharing" mechanism, the "add back" issue will be moot. In any event, the Commission

should consider all of the issues associated with the LEC price cap plan in the comprehensive proceeding. This will permit interrelationships between proposed modifications to the plan to be fully developed on the record. BellSouth therefore recommends that this proceeding be rolled forward into the comprehensive review of the LEC price cap plan.

III. If the Commission adopts an "add back" adjustment, that rule must be given prospective effect only. It cannot retroactively render an existing tariff unlawful.

The fact that the "add back" issue surfaced in the context of the current access tariff filings does not require that the Commission deal with this issue in isolation. The Commission must resolve the tariff issues under the current rules.¹ It would be a violation of the prohibition against retroactive ratemaking to apply rules adopted in this proceeding to evaluate the lawfulness of tariffs filed under the existing price cap rules.² Therefore, the Commission need feel no sense of urgency to deal with the "add back" issue prior to the comprehensive LEC price cap review.

¹Bennett v. New Jersey, 470 U.S. 632, 639-40 (1985); Greene v. United States, 376 U.S. 149, 160 (1964); Rodulfa v. United States, 461 F.2d 1240, 1247 (D.C. Cir. 1972).

²See Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988). See also the definition of "rule" in the Administrative Procedures Act, 5 U.S.C.A. Sec. 551(4), which limits rules to agency statements having "future effect" and which constitute prescriptions "for the future". The APA definition limits rules to prospective, not retroactive, application, at least in the absence of direct Congressional authorization for retroactive rulemaking. See Justice Scalia's concurring opinion in Bowen, supra.

IV. An "add back" adjustment is not permitted by the current rules.

Under the current rules, sharing is based on rate of return thresholds. As required by the Commission's rules, for price cap LECs, the rate of return is calculated on FCC Form 492A. Part 65 of the rules details the required rate of return calculations for the LECs. Each element of the rate base and the components of net income are spelled out in Part 65. Subpart E of Part 65 specifies how rates of return are to be reported. The requirement that LECs file rate of return reports (FCC Form 492 or Form 492A) arises from Section 65.600(d)(1) of the rules.

The Commission recognized that changes were needed to Form 492 to accommodate price cap regulation and specifically delegated to the Common Carrier Bureau the authority to make the needed revisions to the form. NPRM at para. 10. LEC Price Cap Order at para. 384. The Bureau made the revisions necessary to implement the price cap rules and released FCC Form 492A. However, since "add back" was not a part of the LEC price cap plan, the Bureau properly did not include the "add back" calculation that had been a part of Form 492 for rate of return carriers. See 47 C.F.R. Sec. 0.291(h) of the Rules.

In its direct case in connection with the 1993 annual

access tariffs³, NYNEX argues that add back is required in the calculation of 1992 earnings because the price cap order did not eliminate the continuing requirement that price cap LECs report earned revenues in their Form 492 rate of return reports. An analysis of the old FCC Form 492 and the new FCC Form 492A demonstrates just the opposite, i.e., that no add back is included in the rate of return calculation for price cap LECs.

On both Form 492 and Form 492A, lines 1 through 5 are essentially identical, with line 1 representing actual revenues, unadjusted for refunds or add back. On line 6, Form 492 reports FCC ordered refunds in the base period.⁴ Significantly, Form 492 then adds the refund amount to operating income (line 3) to calculate a "Net Return" on line 7. This figure is then used to calculate a new rate of return, including the add back of refunds, on line 8. No such calculations exist on the revised form. On Form 492A, the sharing/low end adjustment amount reported on line 6 is not used in any further calculations of rate of return. The only rate of return reported on Form 492A is that on line 5, which makes no use of the amount reported on line 6. This comparison of the two forms makes it clear that "add back"

³In the Matter of 1993 Annual Access Tariff Filings, CC Docket No. 93-193, Direct Case of the NYNEX Telephone Companies (July 27, 1993).

⁴Line 6 of Form 492A reports any sharing/low end adjustment amount for the base period.

forms no part of the rate of return calculations under the LEC price cap orders or rules. NYNEX is simply incorrect when it argues that the NPRM merely "clarifies" that the price cap rules require that an "add back" adjustment should be made to revenues on line 1 of Form 492A.⁵ As the NPRM correctly recognizes, the addition of an "add back" adjustment to the LEC price cap plan requires changes to the price cap rules and Form 492A.⁶ Any such change must be given prospective effect only or it would violate the prohibition against retroactive rulemaking.⁷

The present situation is analogous to the Commission's consideration of promotional rates in the AT&T price cap plan.⁸ In that proceeding the Commission, on

⁵NYNEX Direct Case at 3. It is on line 7 of Form 492 that refunds were "added back", not through an adjustment to revenues on line 1, as suggested by NYNEX. If line 1 had been adjusted for "add back" then the refund amount would have been double counted in the rate of return calculated on line 8.

⁶This is recognized in the NPRM at para. 6: "This approach [add back] is implemented by including a line-item on the rate of return monitoring report, Form 492, which displays the amount of refunds associated with prior enforcement periods. The refunds are then 'added back' into the total returns used to compute the rate of return for the current enforcement period." No such calculations are required on Form 492A for price cap LECs.

⁷See the authorities cited in Part II, supra.

⁸Policy and Rules Concerning Rates for Dominant Carriers, 4 FCC Rcd 2873 (1989), recon., 6 FCC Rcd 665 (1991).

reconsideration⁹, attempted to clarify the AT&T price cap plan to exclude promotional rates, and to apply the "clarification" retroactively to AT&T's price cap indices. On appeal, the Court of Appeals reversed the reconsideration order.¹⁰ The Court held that the removal of promotional rates from the PCI was not a mere "clarification":

The Commission, however, fails to cite any ambiguity in the Price Cap Order or its resulting rules that raise questions concerning the proper treatment of promotional rates under that order.¹¹

Like the AT&T price cap plan, the LEC price cap plan and rules are silent on the "add back" issue.¹² There is therefore no ambiguity to "clarify". If the Commission wants to adopt an "add back" adjustment to the LEC price cap plan, it must do so through rulemaking with prospective effect only.¹³ The Commission cannot lawfully adopt new rules that would render existing tariffs, filed in

⁹Here the argument against retroactivity is even stronger, since no party petitioned for reconsideration of the LEC price cap plan on this issue. Furthermore, the only intervenors raising the "add back" issue in the 1993 tariff review proceedings opposed an "add back" adjustment.

¹⁰AT&T v. FCC, 974 F.2d 1351 (D.C. Cir. 1992).

¹¹Id., 974 F.2d at 1355.

¹²The fact that the "add back" issue "was neither expressly discussed in the LEC price cap orders nor clearly addressed in our Rules" was expressly recognized by the Commission in the NPRM at para. 4.

¹³In this instance, the first application of any revision to the sharing rules would be in tariffs that would become effective on July 1, 1994. Those tariffs would reflect sharing from the calendar year 1993 base period.

compliance with the existing rules, unlawful.¹⁴

In addition to the prohibition against retroactive ratemaking, there is no public benefit to be derived from an attempt to apply an "add back" adjustment to existing tariff rates. As pointed out in the NPRM, the net impact of retroactive adoption of an "add back" adjustment would be to increase rates by more than \$20 million. NPRM at para. 2. Thus, ratepayers would be harmed by retroactive adoption of an "add back" adjustment.

Despite the fact that the LEC price cap rules do not require "add back" and BellSouth filed its annual access tariff in full accord with the existing rules, the Commission suspended BellSouth's rates and made them subject to an investigation.¹⁵ BellSouth filed its Direct Case in the tariff investigation on July 27, 1993. The lawfulness of BellSouth's tariff rates can only be judged based on the rules in effect at the time the tariff filing was made. Therefore, the Commission should immediately withdraw the accounting order and terminate the investigation of

¹⁴The Commission apparently recognizes this point in the Notice of Proposed Rulemaking adopted following the D.C. Circuit's remand of AT&T, supra. See In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Order and Notice of Proposed Rulemaking, FCC 93-206, released May 21, 1993 at para. 12. ("This would not impede AT&T's ability to offer promotions, nor would it affect the lawfulness of any existing tariff.")

¹⁵1993 Annual Access Tariff Filings, CC Docket No. 93-193, Memorandum Opinion and Order Suspending Rates and Designating Issues for Investigation (DA 93-193), released June 23, 1993.

BellSouth's tariffs as it relates to the "add back" issue.

Because the outcome of this rulemaking cannot affect the lawfulness of the 1993 access tariff filings, the Commission should defer the consideration of the issues in this proceeding to the comprehensive LEC price cap review. However, should the Commission proceed with this rulemaking at this time, the Commission should address all of the rules involved in the sharing mechanism, i.e., Part 65 as well as Part 61.

V. The Commission should consider all rules affected by an "add back" adjustment, not just Part 61.

The NPRM suggests a change in the definition of the base period in Section 61.3(e) of the Rules. The sharing mechanism relies on reported earnings calculated in accordance with Part 65 of the Rules. If the Commission intends to address the "add back" issue, it should consider revisions to all affected Rules, including Part 65 and Form 492A, not just Part 61. Thus, the rule change proposed in the NPRM is inadequate to accomplish the Commission's stated purpose. The Commission must also modify Form 492A, as recognized in the NPRM at para. 6.

VI. If the Commission adopts an "add back" adjustment, it should also adopt a credit for below cap rates.

The NPRM seeks comment on whether, if the Commission adopts an "add back" adjustment, it should also adopt a credit for below cap rates. NPRM at para. 16. The "sharing" mechanism engrafted onto the LEC price cap plan

damages the efficiency incentives inherent in price cap regulation by incorporating a rate of return overlay onto a pure price cap plan. LEC Price Cap Order at para. 121. As the Commission correctly notes, adoption of an "add back" mechanism would further damage the efficiency incentives of the LEC price cap plan. NPRM at para. 14. Adoption of a credit for below cap rates would at least offset, to some extent, the damage caused by "add back" and would provide a positive incentive for price cap LECs to propose lower rates.¹⁶

As BellSouth envisions the proposed credit, carriers that price below the cap would calculate the amount by which they priced below the cap in the base period. That amount would be deducted from the earned return calculated on the Form 492A to determine the subsequent year sharing obligation, if any. Thus, the adoption of such a credit would provide carriers with a positive incentive to price below the cap on a voluntary basis. In effect, this adjustment would create a positive incentive similar to that intended by the adoption of the optional 4.3 percent productivity offset: a LEC would provide its customers with a voluntary, up front rate reduction in exchange for the possibility of reduced sharing if, despite lower rates, it can achieve higher earnings in the base period.

¹⁶Like the proposed "add back" adjustment, a credit for below cap rates would constitute a change in the price cap rules that can have only prospective effect.

VII. The Commission should also correct a flaw associated with the optional 4.3 percent productivity offset.

If the Commission continues with this separate rulemaking, it should also immediately correct a serious flaw in the current price cap rules dealing with the optional 4.3 percent productivity offset. When a company selects the optional 4.3 percent productivity offset, it must reduce its PCI by an additional one percent in the base year. By making this voluntary reduction, the carrier is afforded a 100 basis point increase in the sharing thresholds in the subsequent year. However, the increase in the sharing threshold is treated as a one year "exogenous" change, whereas the decrease in the PCI is permanent. Therefore, selecting a 4.3 percent productivity offset requires a company to reduce its PCI permanently while receiving only a one year potential sharing advantage. This impact becomes even more perverse if the 4.3 percent level for the productivity offset is selected over multiple years. The Commission can remove this perversity by treating both the voluntary reduction in the PCI and the higher sharing threshold as exogenous events that are reversed after one year.

BellSouth selected the 4.3 percent productivity offset in its 1992 annual access tariff filing. BellSouth would have been inclined to select the 4.3 percent productivity offset again in its 1993 filing if it had not been for this perversity in the LEC price cap plan. The Commission's

whole purpose in adopting the optional, higher productivity offset was to encourage carriers to provide customers with larger than required, up front price reduction in exchange for the possibility of retaining higher earnings in the subsequent year. If the Commission corrects the flaw in the 3.3/4.3 percent productivity offset identified above, carriers will be provided with an incentive to consider the higher 4.3 percent productivity offset for their 1994 access tariff filings.

VIII. Conclusion.

In conclusion, BellSouth urges the Commission to defer the issues raised in the NPRM to the comprehensive review of the LEC price cap plan scheduled to begin in just a few months. If, however, the Commission proceeds with an immediate review of the desirability of an "add back" adjustment, the Commission must apply any new rules adopted in this proceeding prospectively only. Attempts to apply any rules adopted in this proceeding to judge the lawfulness of existing tariffs would clearly violate the prohibition against retroactive ratemaking contained in the Administrative Procedures Act. If the Commission proceeds with this rulemaking, it should adopt a credit for below cap rates and it should consider correcting other flaws in the

rules such as the optional 4.3 percent productivity offset
identified in these comments.

Respectfully submitted:

BELLSOUTH TELECOMMUNICATIONS, INC.
By its Attorney:

A handwritten signature in dark ink, appearing to read "M. Robert Sutherland", is written over a horizontal line.

M. Robert Sutherland
4300 Southern Bell Center
675 W. Peachtree Street, NE
Atlanta, GA 30375

Phone: (404) 529-3854

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